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U.S. SENATE REPUBLICAN POLICY COMMITTEE

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Background and Concerns about the Proposed COBRA Subsidy in the Stimulus Bill

Stimulus, or Just Plain Government Spending?

Executive Summary

- The Democrats' stimulus bill contains a number of health provisions of questionable economic value. Notably, the Senate and House stimulus bills both contain a new Consolidated Omnibus Budget Reconciliation Act (COBRA) health insurance subsidy.
- These proposals will likely have little if any stimulative impact on the economy. In fact, data shows that they might actually hurt economic growth by increasing health care costs for businesses and employed workers.
- The *Wall Street Journal* wrote in a recent editorial that "COBRA was never intended as an option to assist the long-term unemployed—considering that adverse selection means COBRA enrollees cost businesses about 145 percent as much as covered employees. Since Democrats want to boost participation by propping up COBRA use, that will result in less capital to invest in new jobs in the middle of a recession."
- The subsidies do not effectively target those who need assistance. Under the proposal, Wall Street millionaires and billionaires like former Lehman Brothers CEO Richard S. Fuld, Jr., who was reported to have earned nearly half a billion dollars in total compensation, could be eligible for a new public health care subsidy.
- A number of common-sense amendments could improve the legislation. These include imposing an income or asset test for any new public subsidies, extending the health care options to include insurance policies offered on the individual market, and limiting the subsidies to people who had previous health care coverage.
- The need to address health care coverage in light of the economy does highlight serious problems with our health care system. While these issues can and should be confronted by Congress, the proposed subsidies divert resources away from these problems and toward solutions that do not efficiently or effectively address the real issues.

I. Introduction

The Democrats' stimulus bill contains a number of health provisions of questionable economic value. Notably, the Senate and House stimulus bills both contain a Consolidated Omnibus Budget Reconciliation Act (COBRA) health insurance subsidy. The House goes one step further by including a new Medicaid buy-in program allowing workers getting unemployment checks to qualify for Medicaid, the health program for low-income people. Spouses and children could also receive benefits, no matter how much money the family has. The *New York Times* wrote that, "The stimulus bill working its way through Congress is not just a package of spending increases and tax cuts intended to jolt the nation out of recession. For Democrats, it is also a tool for rewriting the social contract with the poor, the uninsured and the unemployed, in ways they have long yearned to do."¹

These proposals are problematic for a number of reasons. First, they will likely have little if any stimulative impact on the economy. In fact, data shows that they might actually hurt economic growth by increasing health care costs for businesses and employed workers. Second, history shows that new federal subsidies are difficult, if not impossible, to end once they start. The COBRA and Medicaid expansions are at odds with many proposals to enact broader health care reform, and they divert more than \$30 billion that could be used to support comprehensive reform. Finally, the programs are ineffectively targeted at those who need assistance. The new COBRA subsidy will largely reimburse with federal tax dollars those who already chose to elect COBRA coverage without taxpayer support. More importantly, Wall Street millionaires and billionaires like former Lehman Brothers CEO Richard S. Fuld, Jr., who was reported to have earned nearly half a billion dollars in total compensation, could be eligible for public health care subsidies if this legislation passes without amendment. That certainly would not be a wise or efficient use of taxpayer dollars.

This document outlines the proposals, identifies some of the major concerns, and provides some suggestions as to how these policies could more effectively target scarce resources.

II. Background on COBRA and Proposed Subsidy

COBRA allows workers who have lost their jobs to continue their health care coverage for themselves and their families for up to 18 months. The employee must pay 102 percent of the cost of coverage (100 percent of the cost of the insurance premium plus a 2 percent administrative fee). COBRA applies to employers with 20 or more employees, although 40 states have expanded coverage to include smaller employers.² An employee has 60 days after a qualifying event to elect COBRA coverage. Selecting COBRA coverage may be important to maintaining Health Insurance Portability and Accountability Act (HIPAA) protections in the individual market by maintaining continuous coverage.

¹ *New York Times*, "Relief Seen for Jobless and States in Health Care Plan," January 28, 2009.

² Kaiser Family Foundation, State Health Facts, "Expanded COBRA Continuation Coverage for Small Firm Employees, 2007." Available at: <http://www.statehealthfacts.org/comparetable.jsp?ind=357&cat=7>.

The Democrats' stimulus bill contains a new federal subsidy to pay 65 percent of the cost of COBRA coverage for a period not to exceed nine months. A person qualifies for the subsidy by the loss of group health plan coverage on account of "involuntary termination" of employment. The qualifying event must occur during the period beginning September 1, 2008 and ending December 31, 2009. The subsidy terminates if the individual is offered health care under a new group health plan or becomes eligible for Medicare. The proposal also creates a new 60 day election period for those who are eligible for the subsidy but who did not elect coverage prior to the new benefit being available. However, this does not extend the period of COBRA coverage beyond the time the individual could have qualified. The worker will only pay 35 percent of the cost of COBRA, and the former employer will be responsible for paying the rest. The employer can then treat this cost as a credit against its payroll tax liability. The Congressional Budget Office (CBO) estimates the provision will cost \$25.3 billion.

In addition, the House bill (H.R. 598) requires employers to allow COBRA-eligible workers who are either age 55 or have 10 years of service to enroll and maintain COBRA coverage until age 65 (the age of Medicare eligibility), or until they obtain coverage through other employment. CBO estimates that the House bill will cost \$30.3 billion.

III. Concerns with the Proposal

A COBRA subsidy will not provide an effective economic stimulus: In order to qualify for inclusion in an economic stimulus plan, policies should effectively stimulate the economy. However, providing a COBRA subsidy could have the opposite effect. The new COBRA subsidy could drive up the cost of health care coverage for many individuals and businesses. This will force individuals to commit more of their wages to health care, and away from other more productive uses. It will also force businesses to spend more on health care, which may make it harder for them to retain, or rehire, workers.

The reasoning is simple: those who take up COBRA coverage use more health care than average workers. According to a study cited by Families USA in a recent report, average claims costs for COBRA continuees are 145 percent that of active employees.³ Because workers who elect COBRA coverage consume more health care than the average worker, they will drive costs up for the employer pool as a whole. This means that workers who keep their jobs will pay more for health care. Similarly, businesses that self-insure will be forced to absorb the extra expense of these workers, thereby reducing their ability to invest in business expansion. As the *Wall Street Journal* wrote in a recent editorial, "COBRA was never intended as an option to assist the long-term unemployed—considering that adverse selection means COBRA enrollees cost businesses about 145% as much as covered employees. Since Democrats want to boost participation by propping up COBRA use, that will result in less capital to invest in new jobs in the middle of a recession."⁴ Instead of having a stimulating effect, this policy could actually create a drag on the economy.

³ According to the study, only 26.6 percent of those eligible for COBRA actually elected the health care coverage offered. Spencer's Benefits Reports, "Cost of COBRA Was 145% Of Active Employee Cost, According To Spencer's 2006 COBRA Survey," December 5, 2006, available at: <http://hr.cch.com/news/benefits/120506.asp>.

⁴ *Wall Street Journal*, Editorial, "The Entitlement Stimulus," January 29, 2009.

A study by the HR Policy Association found that the House version of the stimulus package, which includes COBRA continuation for workers aged 55-65, would increase employer health care costs by \$39-\$65 billion.⁵ This increased cost on employers and workers would likely more than offset any stimulative impact of the policy. The study also found that the COBRA expansion would be particularly harmful to small businesses because they have smaller risk pools across which to spread the potentially high cost of one or more COBRA claimants: “This would force these employers to pass substantial cost increases on to their active employees or drop coverage altogether.”⁶

The COBRA subsidy program could encourage employers to drop or limit severance packages: Many employers offer severance packages to continue health insurance coverage for their workers for a limited time. In an analysis of a similar proposal, CBO questioned whether employers would respond to a new subsidy by dropping this coverage extension.⁷ Policymakers should be cautious of providing incentives for the private sector to drop extended health insurance benefits by replacing them with government COBRA subsidies.

States should not be encouraged to expand Medicaid programs that are already over budget: In addition to the new COBRA subsidy, the House stimulus bill contains a Medicaid buy-in option for individuals who did not have health insurance coverage through their employer. [Note: This provision is not contained in the Senate bill. However, it could be added on the floor or in conference.] In arguing for the new Medicaid buy-in program, Families USA cited statistics showing that, “As of December 2008, at least 44 states have faced or are facing budget deficits for the current 2009 fiscal year and/or the coming 2010 fiscal year, and in 2010, states’ budget shortfalls are expected to total \$145 billion.”⁸

It makes no sense to encourage states to expand their Medicaid programs in the face of these mounting shortfalls. History shows that once new entitlement programs are created, they are very difficult to eliminate. The new Medicaid buy-in would therefore encourage states to deepen their financial predicaments rather than reduce spending as needed.

III. Proposals to more effectively target any new programs

CBO performed an analysis on similar proposals to provide temporary health insurance subsidies to unemployed workers.⁹ They suggested that policymakers could consider limitations to more effectively target any new benefit. This could include making any new benefit conditional on the receipt of unemployment insurance benefits, a sufficiently low income, or previous insurance coverage.¹⁰ Following on these recommendations, below are some ideas to more effectively target any new subsidies.

⁵ HR Policy Associates, COBRA Policy Brief, January 22, 2009.

⁶ HR Policy Associates, COBRA Policy Brief, January 22, 2009.

⁷ Congressional Budget Office, “Proposals to Subsidize Health Insurance for the Unemployed,” January, 1998. Available at: <http://www.cbo.gov/ftpdocs/3xx/doc317/subhi.pdf>

⁸ Families USA, “Squeezed: Caught Between Unemployment Benefits and Health Care Costs,” January, 2009. Available at: <http://www.familiesusa.org/assets/pdfs/cobra-2009.pdf>.

⁹ Congressional Budget Office, “Proposals to Subsidize Health Insurance for the Unemployed,” January, 1998.

¹⁰ Congressional Budget Office, “Proposals to Subsidize Health Insurance for the Unemployed,” January, 1998.

- **Ensure the COBRA subsidies don't go to Wall Street millionaires and others who can afford to pay the cost of COBRA:** The COBRA subsidy as written will provide a benefit to any unemployed worker, no matter their income. It also makes no distinction between people who have already opted to elect COBRA coverage and those who could not afford to elect coverage if not for the availability of a new public subsidy. The new COBRA subsidy would provide federal subsidies to Wall Street Bankers who made million dollar bonuses last year, but who are now unemployed. This would include former Lehman Brothers CEO Richard S. Fuld, Jr., who was reported to have earned nearly half a billion dollars in total compensation. Subsidizing millionaire or billionaire bankers surely cannot be the intent of the COBRA subsidy.
- **Provide a dollar limit on the COBRA subsidy so that taxpayers don't subsidize overly-generous benefit packages:** Taxpayers should not be asked to subsidize payments for Cadillac health benefit packages. CBO suggested that "policymakers might want to set a maximum limit on the monthly dollar amount of the subsidy to avoid subsidizing unusually generous health benefit packages."¹¹
- **Extend the subsidy to individuals who purchased coverage through the individual market:** The Medicaid buy-in program will incentivize individuals who purchased health care in the private market to drop their private health insurance in order to take advantage of the public subsidy. To be equitable and avoid this crowd-out effect, the subsidy should therefore also apply to individuals who purchased health care on the individual market. Additionally, in many cases it will be cheaper for people to buy a policy in the individual market than to purchase COBRA coverage. Finally, Families USA notes that 37 states have "conversion" laws that allow states to convert employer-based coverage into a policy in the individual market.¹² Any new subsidy should protect these individuals as well as those who elect to maintain their COBRA benefit.
- **Limit the subsidy to people who had health insurance before becoming unemployed:** The COBRA subsidy and Medicaid expansion could reward people who did not have prior health coverage while penalizing people who acted responsibly by securing employer-based coverage or coverage on the individual market. To guard against this, a previous-coverage requirement should be included in any legislation. CBO wrote that, "If continuity of insurance coverage is viewed as a principal goal of health policy initiatives for the unemployed, it would be reasonable to restrict the new subsidy to workers who had participated in employment-based insurance plans for some required length of time before becoming unemployed. ... A previous-coverage requirement would restrict the new subsidies to people who had shown some commitment to staying insured."¹³
- **Limit the subsidy to families and not individuals:** The Families USA study on COBRA costs is cited for the need to subsidize COBRA benefits for the unemployed. However, a closer look at the study shows that the burden on families trying to maintain health care coverage is much greater than for individuals. The simple reason is that, according to the numbers cited in the study, unemployment benefits are provided to an individual regardless of family size, but the cost of COBRA coverage increases significantly for family coverage. For an individual, the unsubsidized COBRA benefit remains affordable at 30.4 percent of unemployment benefits. The burden is much

¹¹ Congressional Budget Office, "Proposals to Subsidize Health Insurance for the Unemployed," January, 1998.

¹² Families USA, "Squeezed: Caught Between Unemployment Benefits and Health Care Costs," January, 2009.

¹³ Congressional Budget Office, "Proposals to Subsidize Health Insurance for the Unemployed," January, 1998.

greater, however, for family coverage since the cost of family coverage is 83.6 percent of unemployment benefits. (*See Families USA chart below*). Any subsidy could therefore be limited to families and not to individuals.

**Burden of COBRA for Individuals and Families
Receiving Unemployment Benefits, 2008**

	Average Monthly Unemployment Income	Average Monthly COBRA Premium	Premium as Share of Unemployment Income
Family	\$1,278	\$1,069	83.6%
Individual	\$1,278	\$388	30.4%

IV. Conclusion

The COBRA and Medicaid subsidies as designed do not effectively target taxpayer dollars and they will not provide an effective stimulus to the economy. At a minimum, the COBRA subsidy should require an income or asset test to ensure that temporarily unemployed Wall Street millionaires and billionaires are not receiving a new federal subsidy. The need to address health care coverage in light of the economy does highlight major problems with our health care system. In particular, it shows how difficult it may be to get health care without the preferable tax treatment and purchasing arrangements available through large employers. While these issues can and should be confronted by Congress, the new COBRA and Medicaid subsidies divert resources away from that problem and towards solutions that do not efficiently or effectively address the problem.